



The Wrong Kind of Sales Tax Holiday: Misusing Resale Certificates

Betty T. Yee

Imagine buying that luxurious fur coat tax-free in time to wear for Christmas! Sounds like a deal? This could be a deal that hurts consumers, retailers, and the state coffers. In particular, when shoppers use resale certificates to purchase for their own use high-end, expensive items, such as furniture, jewelry, and art without paying sales tax reimbursement on those purchases, they are misusing resale certificates.

Resale certificates allow the purchase of items from sellers on a non-tax basis with the understanding that the proper tax will be remitted when items are sold to a final purchaser. Unfortunately, some individuals use resale certificates to make purchases with no intent to resell the items and pay the tax, instead retaining the items for personal use. When this type of tax evasion occurs, the loss in tax revenues – and the burden on compliant taxpayers—can be significant.

Whether you are a purchaser who issues a resale certificate or a seller who accepts these certificates for a sale, here is some information about how to protect yourself from the misuse of resale certificates and the resulting liability for the unpaid tax.

Proper Use of Resale Certificates. Resale certificates help businesses by minimizing the financial burdens they face in maintaining an inventory for resale or creating items for sale. At the same time, they help ensure that sales tax will eventually be paid and remitted to the state.

When a retailer purchases goods from wholesalers, a valid resale certificate allows that retailer to make those purchases without having to pay sales tax reimbursement. Two examples:

Example #1: ABC Bookstore issues valid resale certificates and makes purchases of books without paying sales tax until those books are later sold to its customers.

Example #2: Beautiful Furniture Maker purchases raw wood for incorporation into a custom piece of furniture without paying sales tax or sales tax reimbursement until that custom furniture item is later sold after completion.

Using resale certificates in these instances is appropriate because California law allows retailers to collect a “reimbursement” of the sales tax it owes to the state from the customer when the item is sold. Thus, the tax is collected upon the final sale of the goods and then remitted to the state.

Misuse of Resale Certificates: Sellers Beware. Unfortunately, the use of resale certificates by persons who are not in the business of retail sales or by retailers who do not intend to resell the items they purchase can harm legitimate business activities. When a business improperly uses a resale certificate to avoid paying the tax on items that it does not intend to resell —such as furniture or computers for its own use — that business gains a financial advantage over those businesses that comply with the law and pay the tax reimbursement on such purchases. This type of misuse can be common, especially during the holiday season when some consumers and business owners make purchases of expensive or high-volume inventory for personal use and consumption.

The misuse of resale certificates can also harm unsuspecting sellers who accept these certificates for retail purchases. Businesses that accept resale certificates should protect themselves from the improper use of such documents, since a seller that accepts an improper resale certificate may be held liable for the unpaid tax.

How Businesses Can Protect Themselves. As a business that accepts resale certificates for purchases, here are some steps you can take to ensure the resale certificate of the purchaser is valid and proper:

- Be sure the resale certificate from the purchaser is timely received, includes the purchaser's identifying information such as the purchaser's name, address, and seller's permit number, and describes the items purchased for resale.
- Verify that there is a reasonable relationship between the purchaser's business and the items being purchased for resale. In other words, the purchases made should be the kind of items this purchaser likely would resell in its business.

For example, if a clothing designer presents a resale certificate to a motorcycle shop, the retailer should inquire whether the particular item truly represents a purchase for resale and require a resale certificate containing a statement that the specific property is being purchased for resale in the regular course of business.

Consequences of Misuse. Penalties for the misuse of a resale certificate can be substantial. A purchaser who knowingly misuses a resale certificate may be subject to any or all of the following:

- Liability for the sales tax on the transaction
- Interest
- A penalty equal to the higher of 10% of the tax due or \$500
- A fraud and intent-to-evade penalty of 25%.

Such a purchaser may also be guilty of a misdemeanor punishable by a fine of not less than \$1000 and/or imprisonment up to one year in the county jail.

Available Resources. If you need information on obtaining a seller's permit, issuing a resale certificate, verifying a seller's permit number, and collecting and paying sales tax:

- Call the BOE's toll-free Call Center at (800) 400-7115
- Visit the BOE's website at www.boe.ca.gov where you may also find the following publications:
 - Publication 73, *Your California Seller's Permit*
 - Publication 42, *Resale Certificate Tips*